

Longreach Oil and Gas Limited
Condensed Consolidated Financial Statements
June 30, 2013
(Unaudited)

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Longreach Oil and Gas Limited
Condensed Consolidated Statements of Financial Position
In United States Dollars
(Unaudited)

	Notes	June 30, 2013	December 31, 2012
Assets			
Current			
Cash and cash equivalents		\$ 21,721,409	\$ 30,669,483
Accounts receivable		67,531	353,927
Restricted cash	3	<u>4,565,881</u>	<u>3,204,109</u>
		<u>26,354,821</u>	<u>34,227,519</u>
Investment and advances			
		179,115	181,155
Exploration and evaluation assets	4	12,596,113	7,637,312
Property and equipment	5	<u>83,718</u>	<u>22,157</u>
		<u>12,858,946</u>	<u>7,840,624</u>
		\$ 39,213,767	\$ 42,068,143
Liabilities			
Current			
Accounts payable and accrued liabilities		\$ 892,812	\$ 1,260,039
Related party loan and other liabilities		<u>-</u>	<u>406,833</u>
		892,812	1,666,872
Warrant value attributed in equity financing	7	<u>-</u>	<u>33,779</u>
		892,812	1,700,651
Shareholders' Equity			
Share capital	6	51,003,859	50,797,099
Share based payment reserve		3,358,281	2,903,402
Deficit		<u>(16,041,185)</u>	<u>(13,333,009)</u>
		<u>38,320,955</u>	<u>40,367,492</u>
		\$ 39,213,767	\$ 42,068,143

The accompanying notes are an integral part of these condensed consolidated financial statements.

Longreach Oil and Gas Limited
Condensed Consolidated Statements of Operations and
Comprehensive Loss
In United States Dollars
(Unaudited)

	Notes	Three Months Ended June 30,		Six Months Ended June 30	
		2013	2012	2013	2012
Expenses					
Administrative		\$ 880,610	\$ 517,283	\$ 1,726,207	\$ 882,741
Depreciation	5	7,690	2,238	10,709	3,327
Share based compensation	6	190,465	45,637	356,949	81,294
Foreign exchange loss (gain)		322	67,885	645,445	(62,084)
		<u>1,079,087</u>	<u>633,043</u>	<u>2,739,310</u>	<u>905,278</u>
Other income (loss)					
Finance income		4,893	47,264	14,244	47,264
Warrant fair value adjustment (loss)	7	-	213,732	16,890	(41,380)
		<u>4,893</u>	<u>260,996</u>	<u>31,134</u>	<u>5,884</u>
Net and comprehensive loss for the period		\$ (1,074,194)	\$ (372,047)	\$ (2,708,176)	\$ (899,394)
Net loss per share					
- Basic and diluted		(0.013)	(0.016)	(0.033)	(0.038)
Weighted average shares outstanding					
- Basic and diluted (1)		81,119,324	23,465,398	81,108,102	23,465,398

(1) The options and warrants have been excluded from the diluted loss per share computation as they are anti-dilutive.

The accompanying notes are an integral part of these condensed consolidated financial statements.

Longreach Oil and Gas Limited
Condensed Consolidated Statements of Changes in Shareholders' Equity
In United States Dollars
(Unaudited)

	Share Capital	Share Based Payment Reserve	Deficit	Total Equity
Balance, December 31, 2012	\$ 50,797,099	\$ 2,903,402	\$ (13,333,009)	\$ 40,367,492
Net loss for the period	-	-	(2,708,176)	(2,708,176)
Exercise of warrants	206,760	-	-	206,760
Share-based payments	-	454,879	-	454,879
Balance, June 30, 2013	\$ 51,003,859	\$ 3,358,281	\$ (16,041,185)	\$ 38,320,955

	Share Capital	Share Based Payment Reserve	Deficit	Total Equity
Balance December 31, 2011	\$ 10,277,217	\$ 2,265,889	\$ (998,933)	\$ 11,544,173
Net loss for the period	-	-	(899,394)	(899,394)
Share based compensation	-	81,294	-	81,294
Balance June 30, 2012	\$ 10,277,217	\$ 2,347,183	\$ (1,898,327)	\$ 10,726,073

The accompanying notes are an integral part of these condensed consolidated financial statements.

Longreach Oil and Gas Limited
Condensed Consolidated Statements of Cash Flows
In United States Dollars
(Unaudited)

	Notes	Three Months Ended June 30,		Six Months Ended June 30,	
		2013	2012	2013	2012
Cash flows from (used in) operating activities					
Net loss for the period		\$ (1,074,194)	\$ (372,047)	\$ (2,708,176)	\$ (899,394)
Items not involving cash:					
Foreign exchange loss		2,603	-	77,952	-
Stock based compensation	6	190,465	45,637	356,949	81,294
Warrant fair value	7	-	(213,732)	(16,890)	41,380
Depreciation	5	7,690	2,238	10,709	3,327
		<u>(873,436)</u>	<u>(537,904)</u>	<u>(2,279,456)</u>	<u>(773,393)</u>
Changes in non-cash working capital balances:					
Accounts receivable		113,819	15,643	286,396	3,934
Accounts payable and accrued liabilities		(121,482)	(154,194)	(521,685)	(1,250,103)
Cash flow used in operating activities		<u>(881,099)</u>	<u>(676,455)</u>	<u>(2,514,745)</u>	<u>(2,019,562)</u>
Cash flows from (used in) financing activities					
Loan payable		-	(824,438)	(406,833)	(824,438)
Exercise of warrants		-	-	189,870	-
Share issue costs		-	(80,000)	-	(190,000)
Cash flow used in financing activities		<u>-</u>	<u>(904,438)</u>	<u>(216,963)</u>	<u>(1,014,438)</u>
Cash flows from (used in) investing activities					
Expenditures on evaluation and equipment		(2,429,440)	(503,178)	(4,706,412)	(513,278)
Expenditures on property and equipment		(60,369)	(11,271)	(72,270)	(11,271)
Restricted cash		(1,139,949)	399,234	(1,361,772)	1,574,161
Cash flow from (used in) investing activities		<u>(3,629,758)</u>	<u>(115,215)</u>	<u>(6,140,454)</u>	<u>1,049,612</u>
Decrease in cash and cash equivalents		(4,510,857)	(1,696,108)	(8,872,162)	(1,984,388)
Effect of change of exchange rate on cash and cash equivalents		(1,353)	-	(75,912)	-
Cash and cash equivalents, beginning of period		<u>26,233,619</u>	<u>5,681,115</u>	<u>30,669,483</u>	<u>5,969,395</u>
Cash and cash equivalents, end of period		\$ 21,721,409	\$ 3,985,007	\$ 21,721,409	\$ 3,985,007

The accompanying notes are an integral part of these condensed consolidated financial statements.

Longreach Oil and Gas Limited
Notes to Condensed Consolidated Financial Statements
In United States Dollars
(Unaudited)

June 30, 2013

1. Corporate Information

Longreach Oil And Gas Limited (“Longreach” or “the Company”) is a publicly traded corporation on the TSX Venture Exchange (“TSX-V”) under the trading symbol LOI that is engaged in the evaluation, acquisition, exploration and development of oil and gas properties in Morocco with five exploration licences (*Sidi Moktar onshore, Tarfaya onshore, Zag onshore, Sidi Moussa offshore and Fom Draa offshore*).

Longreach is a Jersey limited company governed by the Companies (Jersey) Law 1991 (the “CJL”). The registered and head office of the Company is located at Queensway House, St Helier, Jersey, Channel Islands, JE1 1ES.

The Company’s business is the business carried on by its wholly-owned subsidiary, Ventures, and that carried on by Longreach Oil and Gas Limited. Ventures was incorporated as a Jersey limited company under the CJL on April 4, 2006. Chairman Capital Corp., a capital pool company and predecessor of Longreach, was incorporated under the Business Corporations Act (Ontario) on May 31, 2006. On August 12, 2010, in connection with a proposed reverse takeover by Ventures, Chairman Capital Corp. changed its name to “Longreach Oil and Gas Limited”, and consolidated its outstanding securities on a 5-to-1 basis. On September 24, 2010, the Company completed a reverse takeover with Ventures (the “Transaction”), which constituted the Company’s qualifying transaction under the Exchange policies governing capital pool companies.

The following sets out the operating subsidiaries of the Company and the Company’s ownership interest in those subsidiaries:

<u>Name of Subsidiary</u>	<u>Jurisdiction of Incorporation</u>	<u>Ownership</u>
Longreach Oil and Gas Ventures Limited	Jersey, Channel Islands	100%
Longreach Oil and Gas (Canada) Limited	Canada	100%
Longreach Oil and Gas UK Ltd.	United Kingdom	100%

2. Basis of Presentation

Statement of compliance

These condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34 Interim Financial Reporting. These condensed consolidated financial statements were authorised for issue by the Board of Directors on August 13, 2013. They do not contain all disclosures required by International Financial Reporting Standards (“IFRS”) for annual financial statements and, accordingly, should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2012.

These condensed consolidated financial statements have been prepared on the historical cost basis, except for the warrants associated with the equity financing which are measured at their estimated fair value. The condensed consolidated financial statements have been prepared using the same accounting policies and methods as the consolidated financial statements for the year ended December 31, 2012.

Effective January 1, 2013 the Company has adopted the following standards, IFRS 7 – “Financial Instruments – Disclosures”, IFRS 10 – “Consolidated Financial Statements”, IFRS 11 – “Joint Arrangements”, IFRS 12 – “Disclosure of Interests in Other Entities”, IFRS 13 – “Fair Value Measurements” and IAS 34 “Amendment to Interim Financial Reporting”. The adoption of these standards has not had any material impact on the Company’s interim financial statements and related disclosures.

Longreach Oil and Gas Limited
Notes to Condensed Consolidated Financial Statements
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June 30, 2013

2. Basis of Presentation - continued

Going concern assumption

The Company is in the process of exploring its oil and gas properties and has not yet established whether the properties contain reserves that are economically recoverable. The recovery of amounts capitalised for property interests on the condensed consolidated statement of financial position are dependent upon the existence of economically recoverable hydrocarbons, the ability of the Company to complete exploration and/or development of the properties, including related financing requirements and upon future profitable production or, alternatively, upon proceeds from the disposition of the properties. To date, the Company has not earned revenues relative to its costs incurred for exploration activities. These condensed consolidated financial statements have been prepared on a going concern basis, under which the Company is assumed to be able to realise its assets and discharge its liabilities in the normal course of operations. The Company's ongoing activities are dependent upon its ability to obtain sufficient financing to fund its current and future operations and future acquisition costs. There is no certainty that such financing will be obtained on terms acceptable to management which may cast significant doubt about the Company's ability to continue as going concern. The condensed consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumptions were not appropriate. If the going concern basis was not appropriate for these consolidated financial statements, then adjustments would be necessary in the carrying value of property and equipment, liabilities, the reported expenses, and the classifications used in the condensed consolidated statement of financial position. Such adjustments could be material.

Functional and presentation currency

These condensed consolidated financial statements are presented in United States ("US") Dollars, which is the Company's functional currency. The following are the US Dollar foreign exchange rates at the respective periods:

Currency	June 30, 2013	December 31, 2012	June 30, 2012
Average rate for the period:			
Pounds Sterling	0.6476	0.6310	0.6341
Canadian Dollar	1.0155	0.9996	1.0059
Euro	0.7616	0.7781	0.7780
Moroccan Dirham	8.4043	8.5511	8.4914
Period end rate:			
Pounds Sterling	0.6572	0.6185	0.6403
Canadian Dollar	1.0515	0.9966	1.0248
Euro	0.7685	0.7565	0.7950
Moroccan Dirham	8.3061	8.4220	8.8369

Use of estimates and judgments

The preparation of financial statements requires the directors to make estimates and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. By their nature, estimates are subject to measurement uncertainty and changes in such estimates in future periods could require a material change in the financial statements. Accordingly, actual results may differ from the estimated amounts as future confirming events occur. Significant estimates and judgments made by the directors in the preparation of these condensed consolidated financial statements are as follows:

Longreach Oil and Gas Limited
Notes to Condensed Consolidated Financial Statements
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(Unaudited)

June 30, 2013

2. Basis of Presentation - continued

- i. The decision to transfer exploration and evaluation assets to property, plant and equipment is based on management's determination of an area's technical feasibility and commercial viability based partially on proved and probable reserves. If no future exploration or development activity is planned for the exploration and evaluation assets the costs incurred will be written off.
- ii. Amounts recorded for decommissioning obligations and the related accretion expense requires the use of estimates with respect to the amount and timing of decommissioning expenditures. Other provisions are recognised in the period when it becomes probable that there will be a future cash outflow. The Company has yet to record any decommissioning obligations due to its early stage of developing its licences.
- iii. Compensation costs recognised for share based compensation plans are subject to the estimation of what the ultimate payout will be using pricing models such as Black-Scholes model which is based on significant assumptions such as volatility, dividend yield and expected term.
- iv. The Company's non-compensation based warrants are treated as derivative financial liabilities. The estimated fair value of each is adjusted on a quarterly basis with gains or losses recognised in the statement of operations and comprehensive income. The Black-Scholes model is based on significant assumptions such as volatility, dividend yield and expected term.
- v. Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. Therefore, income taxes are subject to measurement uncertainty. Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realised from future taxable earnings. The Company has yet to record any deferred tax assets.

3. Restricted Cash

	June 30, 2013	December 31, 2012
Zag licence	\$ -	\$ 150,000
Tarfaya licence (Note 8)	300,000	300,000
Zag exploration licence (Note 8)	600,000	225,000
Sidi Moktar farm-in arrangement (Note 8)	2,500,000	2,500,000
Sidi Moktar (1)	1,139,900	-
Other	25,981	29,109
	<u>\$ 4,565,881</u>	<u>\$ 3,204,109</u>

(1) Amounts related to funds held by the Company's financial institution for supplier commitments with respect to the upcoming 2013/14 drilling programme.

4. Exploration and Evaluation Assets

Balance, December 31, 2012	\$ 7,637,312
Additions	5,238,791
Back cost recoveries received pursuant to farm-outs	(279,990)
Balance, June 30, 2013	<u>\$ 12,596,113</u>

Longreach Oil and Gas Limited
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(Unaudited)

June 30, 2013

4. Exploration and Evaluation Assets - continued

The Company's exploration and evaluation assets consist entirely of costs pertaining to the Company's licences in Morocco. At June 30, 2013, no costs were considered to be impaired; however, the evaluation of the technical feasibility or commercial viability of the licences has not been determined. During the period ended June 30, 2013, the Company expensed \$nil (2012 - \$nil) related to pre-licence costs. During the six month period, the Company received \$279,990 with respect to back costs from the Sidi Moussa offshore and Fom Draa offshore farm-out partners.

During the six month period, the Company capitalised \$252,767 (2012 - \$nil) of administrative costs and salaries and \$97,930 related to share based payments directly related to exploration and evaluation activities on the Sidi Moktar license.

5. Property and Equipment

Cost

Balance, December 31, 2012	\$	35,037
Additions		72,270
Balance, June 30, 2013	\$	<u>107,307</u>

Accumulated depreciation

Balance, December 31, 2012	\$	(12,880)
Depreciation charge		(10,709)
Balance, June 30, 2013	\$	<u>(23,589)</u>

Net book value

Net book value, December 31, 2012	\$	22,157
Net book value, June 30, 2013	\$	<u>83,718</u>

The Company's property and equipment consists of office equipment and furniture and is located in Jersey, Morocco, Canada and in the United Kingdom.

6. Share Capital

(a) Authorised

Unlimited number of Common Shares without nominal or par value

(b) Issued

	June 30, 2013		December 31, 2012	
	Issued	Amounts	Issued	Amounts
Common Shares				
Opening balance	80,829,145	\$ 50,502,432	23,465,398	\$ 9,888,470
APIC transaction	-	-	57,363,747	40,613,962
Exercise of warrants	290,179	206,760	-	-
Balance, end of period	<u>81,119,324</u>	<u>\$ 50,709,192</u>	<u>80,829,145</u>	<u>\$ 50,502,432</u>

Longreach Oil and Gas Limited
Notes to Condensed Consolidated Financial Statements
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June 30, 2013

6. Share Capital - continued

Warrants (Note 7)

Opening balance	715,863	\$	294,667	947,252	\$	388,747
Expired broker warrants	-		-	(231,389)		(94,080)
Balance, end of period	715,863	\$	294,667	715,863	\$	294,667
		\$	51,003,859		\$	50,797,099

(c) Stock options

The Company has a stock option plan that provides for the issuance to its directors, officers, employees and consultants options to purchase from treasury a number of common shares not exceeding 10% of the common shares that are outstanding from time to time which is the number of shares reserved for issuance under the plan. The options vest at various rates as determined by the Board. The maximum term of the options is five years. The options are non-transferable if not exercised. A summary of the status of the Company's stock option plan as at June 30, 2013 and December 31, 2012 and changes during the respective periods ended on those dates is presented below:

Stock Options	June 30, 2013		December 31, 2012	
	Number of options	Weighted average Exercise Price (CAD \$)	Number of options	Weighted average exercise price (CAD \$)
Beginning of period	3,133,707	\$0.94	1,700,000	\$1.10
Granted	4,145,000	\$0.70	500,000	\$0.60
APIC replacement grant	-	-	1,433,707	\$0.92
Forfeited	-	-	(500,000)	(1.10)
End of period	7,278,707	\$0.80	3,133,707	\$0.94
Exercisable, end of period	2,567,040	\$1.00	2,400,373	\$1.00

Date of Grant	Number Outstanding	Exercise Price (CAD \$)	Weighted Average Remaining Contractual Life	Date of Expiry	Number Exercisable June 30, 2013
August 16, 2011	500,000	\$1.20	0.46 years	December 16, 2013	500,000
August 16, 2011	650,000	\$1.05	1.13 years	August 16, 2014	433,333
October 3, 2011	50,000	\$0.75	1.26 years	October 3, 2014	33,333
May 22, 2012	500,000	\$0.60	3.90 years	May 22, 2017	166,667
December 21, 2012	258,141	\$0.54	0.48 years	December 21, 2013	258,141
December 21, 2012	181,999	\$0.54	1.22 years	September 17, 2014	181,999
December 21, 2012	139,284	\$0.54	1.79 years	April 15, 2015	139,284
December 21, 2012	167,141	\$1.18	0.48 years	December 21, 2013	167,141
December 21, 2012	687,142	\$1.18	3.67 years	February 28, 2017	687,142
January 15, 2013	3,845,000	\$0.70	4.55 years	January 15, 2018	-
May 16, 2013	300,000	\$0.70	4.88 years	May 16, 2018	-
	7,278,707		3.45 years		2,567,040

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6. Share Capital - continued

The weighted average fair market value per option of \$0.37 (CAD) was estimated using the Black-Scholes option pricing model with the following assumptions: dividend yield – nil, expected volatility 75%, risk free rate – 1.5%, expected life - 5 years and an estimated forfeiture rate – 5% and utilising the graded option method. The volatility was determined via a peer comparison due to the limited trading volume of the Company's shares on the TSX-V.

(d) Escrowed securities

Pursuant to an Escrow Agreement, all of the 6,426,506 common shares and 325,806 share purchase warrants held by "principals" prior to the 2010 capital transaction, were deposited in trust and held in escrow. 10% of these shares were released on October 4, 2010 upon completion of the capital transaction and 15% will be released on each six month anniversary of that date. The Company has 963,976 common shares and 48,763 share purchase warrants remaining in escrow at June 30, 2013. These common shares and share purchase warrants will be released from escrow on October 4, 2013.

7. Warrants Value Attributed in Equity Financing

(a) Warrants issued and outstanding

	June 30, 2013		December 31, 2012	
	Warrants	Amounts	Warrants	Amounts
Warrants (i)				
Opening balance	10,946,663	\$ 33,779	12,478,499	\$ 304,680
APIC replacement warrants	-	-	580,358	39,793
Exercised - non-compensatory	(290,179)	(16,889)	-	-
Expired – non-compensatory	(9,940,621)	NA	(1,880,805)	NA
Expired – compensatory	-	NA	(231,389)	NA
Fair value adjustment	-	(16,890)	-	(310,694)
Balance, end of period	715,863	\$ -	10,946,663	\$ 33,779

(i) Only values related to the non-compensatory warrants have been included in this table and do not include the compensatory warrants included in equity (Note 6(b)).

(b) The following tables summarises the warrants outstanding and exercisable at June 30, 2013:

Number of warrants	Warrant Type	Exercise price (CAD \$)	Expiry date
136,836	Compensatory	\$1.00	October 4, 2013
579,027 (1)	Compensatory	\$1.05	July 29, 2013
715,863			

(1) Subsequent to June 30, 2013, the 579,027 compensatory warrants expired unexercised.

(c) Each non-compensatory warrant is measured at fair value quarterly using the Black-Scholes options pricing model. The Company had no non-compensatory warrants outstanding as at June 30, 2013.

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8. Commitments and Contingencies

(a) Sidi Moktar Onshore Farm-in

On September 19, 2011, Longreach effectively acquired a 50% interest in the Sidi Moktar exploration licences pursuant to a percentage interests transfer agreement (the "Farm-in Agreement") signed with MPE on May 16, 2011. Under the Farm-in Agreement, Longreach is responsible for carrying Maghreb Petroleum Exploration ("MPE") through the minimum work programme commitments required pursuant to the petroleum agreement entered into between MPE and ONHYM, the Moroccan state energy company (the "Petroleum Agreement") in respect of the Sidi Moktar exploration licences. In the event that the joint venture parties to the Petroleum Agreement elect to enter in to an exploitation concession, Longreach will carry MPE for development costs until the first commercially produced hydrocarbons. The Company has posted a bank guarantee of \$2.5 million (Note 3) with respect to this commitment.

(b) Zag Basin Permit

Included in restricted cash is \$600,000 related to certain work commitments that need to be completed by May 2015. The Company has committed to its percentage share of further geophysical studies and the drilling of one exploration well.

(c) Tafaya Onshore Permit

Included in restricted cash is \$300,000 related to certain work commitments that need to be completed by April 2014. The Company has committed to its percentage share of further geophysical studies and the drilling of one exploration well.

(d) Office Leases

The Company has the following office lease agreements with monthly costs exclusive of common costs as follows:

Office Location	Currency of Rental Commitment	Total Base Rent Commitment	2013	2014	2015	2016
Jersey	£	1,800	£1,800	£0	£0	£0
Morocco	MAD	108,000	MAD 108,000	MAD 0	MAD 0	MAD 0
Morocco	€	16,200	€ 10,800	€ 5,400	€ 0	€ 0
UK	£	4,800	£4,800	£0	£0	£0
Canada	\$	110,781	\$ 19,515	\$ 40,326	\$ 40,752	\$ 10,188

The Jersey and United Kingdom office lease arrangements can be terminated on three and one months' notice respectively. The Morocco leases expire on December 31, 2013 and March 31, 2014. The Canadian office lease arrangement expires on March 31, 2016.

(e) In August 2013, the Company entered into a rig contact with Saipem SpA, an Italian based drilling company. Longreach's minimum commitment under the contract is approximately \$5.9 million.

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9. Financial Instruments

The Company may hold various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to, credit, and foreign exchange risks. The Company manages its exposure to these risks by operating in a manner that minimises its exposure to the extent practical.

(a) Foreign Currency Exchange Risk

The Company operates on an international basis and therefore foreign exchange risk exposures arise from transactions denominated in currencies other than USD. The Company is exposed to foreign currency fluctuations as it holds cash and incurs expenditures in property and equipment in foreign currencies. The Corporation incurs expenditures in Pound Sterling, Euros, United States Dollars and Canadian Dollars and is exposed to fluctuations in exchange rates in these currencies. There are no exchange rate contracts in place at June 30, 2013 or December 31, 2012.

Assuming all other variables remain constant, a 1% increase or decrease in foreign exchange rates on the foreign cash balances at June 30, 2013 would have impacted the cash flows of the Company during the three months ended June 30, 2013 by approximately \$37,970.

(b) Interest Risk

Interest rate risk refers to the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company is not exposed to interest rate risk as it has no interest bearing corporate borrowings. The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations.

(c) Market Risk

Market risk is comprised of two components: currency risk and interest rate risk.

(d) Credit Risk

Credit risk is the risk that arises when a party to a financial instrument will be unable to discharge its obligations as they become due. The Company's financial assets exposed to credit risk are cash, restricted cash, and accounts receivable. Cash and restricted cash is placed with major financial institutions. The maximum credit risk is approximate to the carrying value of such financial instruments. Management assesses quarterly if there should be any impairment of the financial assets of the Company. At June 30, 2013, none of the Company's financial assets are considered to be impaired.

(e) Commodity Price Risk

The Company will be subject to commodity price risk for the sale of its production. The Company may enter into contracts for risk management purposes only, in order to protect a portion of its future cash flow from the volatility of petroleum commodity prices. To date the Company has no production and has not entered into any financial instrument exposed to commodity risk.

(f) Fair Value of Financial Instruments

The Company classifies the fair value of these financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

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June 30, 2013

9. Financial Instruments - continued

- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

Cash and restricted cash have been classified as level 1. The non-compensatory warrants were classified as level 2. The investment in the Aizan convertible debenture and non-compensatory warrants are classified as level 2. The investment in the common equity of Aizan has been classified as level 3.

All financial assets (except for cash and cash equivalents and restricted cash which are classified as FVPL), are classified as either loans or receivables and are accounted for on an amortised cost basis. All financial liabilities are classified as other liabilities other than the warrants attributed to equity financing which are classified as FVPL. The investment and advances have been designated as available-for-sale. There have been no changes to the aforementioned classifications during the financial period ended June 30, 2013.

(g) Liquidity Risk

Liquidity risk includes the risk that, as a result of the Company's operational liquidity requirements:

- The Company will not have sufficient funds to settle a transaction on the due date;
- The Company will be forced to sell financial assets at a value which is less than what they are worth; or
- The Company may be unable to settle or recover a financial asset.

The Company's operating cash requirements including amounts projected to complete the Company's existing capital expenditure program are continuously monitored and adjusted as input variables change. These variables include but are not limited to results from new wells drilled, commodity prices, cost overruns on capital projects and regulations relating to prices, taxes, royalties, land tenure, allowable production and availability of markets. When these variables change, liquidity risks may necessitate the Company to conduct equity issues or obtain project debt financing. The loans payable are due on demand and the accounts payable have general terms ranging from 30 to 90 days from receipt of the invoice or joint venture billing.

10. Capital Risk Management

The Company manages its capital with the objective to continue as a going concern, create investor confidence, and meet its capital commitments and to strengthen its working capital position. The capital structure of the Company is primarily composed of shareholders' equity. The Company's strategy is to access capital, primarily through equity issuances, in order to maintain a strong capital base for the objectives of maintaining financial flexibility and to sustain the future development of the business. The Company manages its capital structure and makes adjustments relative to changes in economic conditions and the Company's risk profile.

In order to maintain the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current working capital levels. Bank debt may be added in future periods. The Company is not currently subject to any externally imposed covenants.
